

CITY OF CHENEY
Spokane County, Washington
January 1, 1994 Through December 31, 1994

Schedule Of Findings

1. The City Should Strengthen Controls And Procedures Over The Payroll System

a. The automated payroll system failed to provide accurate data.

(1) Sixty-two employees who did not work during the accounting period showed gross wages, although not paid, in the payroll master file. The total erroneous gross wage amount was \$904,781.87.

(2) Eighty employees had errors in reported gross wages and federal withholdings. Errors were found between the W-2's and the payroll master file. The amount of total difference was \$95,929.86.

(3) Wages recorded in the general ledger were not in agreement with the payroll system.

b. Internal controls over the payroll system are deficient.

(1) Department heads are certifying and approving their own time sheets.

(2) The fire department does not provide adequate documentation to substantiate salary for the volunteer firefighters.

c. The controls and approval of the city's employee benefit programs need improvement.

(1) Although the city agreed to the employee benefits program plan for 1994, the amount of these benefits was not approved by the council. The total benefit amount in 1994 was \$158,865.

(2) The city does not have the benefit package identified or approved in the personnel policy and procedures manual.

(3) Eligible employees are not paid an equitable amount. Thirteen employees did not receive the full benefit amount allocated and five employees exceeded the amount allocated.

(4) Deferred compensation as a benefit is not allowed under Internal Revenue Service (IRS) Section 457. The city matched deferred compensation in the amount of \$6,022. The city also paid into the deferred compensation plan \$27,949 for the benefit of the employees. The city does not maintain subsidiary records to support the changes to the deferred compensation fund.

(5) Due to the employees being allowed to change from taxable to nontaxable

benefits throughout the year, the city inaccurately calculated federal withholdings in the amount of \$10,617 for 19 employees.

RCW 43.09.200 states in part:

The accounts shall show the . . . documents kept or required to be kept necessary to isolate and prove the validity of every transaction

Volume 1, Part 3, Chapter 1, pages 15 and 17-18 of the *Budgeting, Accounting and Reporting System* (BARS) manual, issued by the State Auditor's Office pursuant to RCW 43.09.230, requires the following for entity internal control systems:

An internal control system consists of the plan of organization and methods and procedures adopted by management to ensure that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

Internal control systems and all transactions and other significant events are to be clearly documented, and the documentation is to be readily available for examination.

Internal control weaknesses, such as described, and the lack of accounting policies and procedures do not provide adequate protection of public assets. Weak internal controls increase the potential for the occurrence of fraud and undetected accounting errors.

Management failed to take responsibility for ensuring that formal computer software documentation and written procedures were developed and implemented for the payroll system. Controls were not in place to ensure only authorized data was input into the system, data was input correctly and accurately, and that all data were accessed and manipulated by persons who have proper authority.

Incomplete documentation inhibits the complete understanding of the system's functions, makes the training of new employees more difficult, and causes the modifications of the system to be more complex.

These material weaknesses in the payroll system contributed to the disclaimer on the financial statements.

We recommend that the city improve controls and procedures over the payroll system.

2. The City Should Improve Security Access Controls Over Its Computer Systems

During our examination, we found the following weaknesses in the city's security over access to the computer system. The city does not have a formal authorization procedure for establishing new users on the system. We found one terminated employee which still had an active user code and password. Our tests disclosed that the current method of system security controls does not limit users to only those functions that they need to do their job. Several problems were noted as follows:

- a. Security officer and security administration user classes, who are authorized to add, change, or delete users and data files, are not restricted to key information systems personnel.
- b. Users are not restricted to their menus. They have the capability to change initial settings which define whether the user can change the program, initial menu or current library.
- c. All system users have the change capability. Change capability allows the user to add, change, and delete information in varying levels of the computer.
- d. The security officer's special authority is granted to seven users. Three of the users are identifiable by user code. The remaining four user codes are generic names.
- e. The security administration special authority is granted to three users. One of the users is the self-employed programmer.
- f. The system operator's special authority profile is granted to 34 users, making it possible for 34 people to make changes to the operating system.
- g. A contracted programmer had placed unauthorized software on the city's computer.

We also noted the following weaknesses in access to the city's computing environment:

- a. Remote users are allowed to gain access to the system with minimal restrictions.
- b. A user can leave their terminal indefinitely and the system stay active, thus allowing unauthorized access during their absence.
- c. Users can be signed onto more than one terminal.
- d. The security officer may be signed onto unlimited devices at one time.
- e. Passwords are currently not required to be changed on a timely basis. A user could continue to use the same password indefinitely.
- f. The city does not have a method for monitoring access violations or terminating unauthorized users.

The State Auditor's Office, *General Controls and Application Controls for Computer Systems*, Bulletin 003, states:

Access to program documentation should be limited to those persons requiring it in the performance of their duties. Program documentation

contains information necessary to make changes to programs, data file structures, programmed control criteria, and other elements of applications. As such, it should be subjected to restricted access.

Access to data files and programs should be limited to those authorized to process or maintain particular systems. This control could be implemented through a "library" function applied to both data and program files. The library function can be carried out through the use of library personnel as well as librarian software systems.

The *Electronic Data Processing Auditor's Foundations, Control Objectives*, Section 3.4.1, states:

Access to the computing resources of the Systems Services Department should be limited to those individuals with a documented and authorized need for such access. Layers of logical and physical access controls should be provided to protect the department's computing resources against unauthorized use or modification, damage, or loss.

Access controls are designed to limit access to documentation, files, and programs. A weakness in or lack of such controls increases the opportunity for unauthorized modifications to files and programs, as well as misuse of the computer hardware. Weaknesses in systems software, program, and data security significantly decrease the integrity of the system. Proper access controls will assist in the prevention or detection of deliberate or accidental errors caused by improper use or manipulation of data files, unauthorized or incorrect use of computer programs, and/or improper use of computer resources.

Management has failed to establish proper security control policies and procedures. The current system is not properly implemented to secure the city's information which is an asset.

We recommend that management establish and implement controls and procedures which would provide adequate access security to the city's computer system and operation.

3. The City Should Comply With Bond Covenants

The city failed to meet the revenue requirement of their bond covenants. City Ordinance No. Q-14, Article VI, Section 6.02 states that:

The City will establish, maintain and collect such rates and charges for water and sanitary sewage disposal service so long as any Outstanding Bonds, The Bond, and any Parity Bonds are Outstanding which, together with other miscellaneous Revenue of the System, will provide amounts annually at least equal to 1.25 times the portion of annual debt service, excluding the principal of any Term Bonds, on the Outstanding Bonds, The Bond and any Parity Bonds actually paid from such Revenue of the System, and not from ULID Assessments, after payment of Operating and Maintenance Expenses.

The Water/Sewer Fund of the city failed to meet the operating revenue for requirement for 1994. The operating revenue was deficient by \$34,412. This deficiency was the result of an insufficient rate structure in the operation of the Water/Sewer Fund.

We recommend the city restructure their rates as necessary to assure compliance with all bond covenants.

4. The City Should Develop A Disaster Recovery Plan

The city does not have a disaster recovery plan for its computer operation system. Application and operating system software, as well as programs and other documentation, are not stored at an off-site facility. Nor are supplies of warrants and other critical nonstandard forms stored offsite.

The *Electronic Data Processing Auditor's Foundations, Control Objectives*, Section 3.5.1, states:

Adequate plans should exist for the back up of critical computer resources and for the recovery of information services following unanticipated interruptions of them.

A written plan for processing critical application programs in the event of a major hardware or software failure, or temporary or permanent destruction of facilities, should be maintained.

The city's management was informed of this in prior audit, but has failed to develop a disaster recovery plan. The lack of an adequate backup and recovery plan increases the risk of losing data, programs, and documentation in the event of a disaster. Examples of lost information would be financial records such as receipts, fixed assets, payables, grants, and operational records. The absence of a disaster plan will also delay the reestablishment of support for critical operations.

We recommend that the city develop a disaster recovery plan for its computer operation. This plan should provide for the processing of critical application programs in the event of a major hardware or software failure.

5. The City Should Strengthen Controls And Procedures Over The Voucher System

Our examination of the city's voucher system, which controls all city expenditures, except for the payroll, disclosed deficiencies in both internal controls and accounting procedures. The following weaknesses were noted:

- a. Vouchers were paid based on photocopies of purchase requisitions, purchase orders, invoices, and receipts. We found this to exist in 38 percent of the vouchers tested.
- b. The auditing officer's certification signature was rubber stamped on the voucher by the accounts payable clerk. The auditing officer did not review most vouchers.
- c. Claim vouchers do not identify account coding or total amounts to be paid. A tape total is not used to reconcile the numerous supporting documentation to the voucher.
- d. Supporting documentation was missing from four vouchers tested (represents 6 percent).
- e. Travel vouchers were often completed by the department and not the respective individual. Employee's travel expenditures often lack certification and/or supervisor approval.
- f. The city does not pay all expenditures by the warrant approval process.

RCW 43.09.200 states in part:

The accounts shall show the . . . documents kept or required to be kept, necessary to isolate and prove the validity of every transaction

Internal control weaknesses, such as described, do not provide adequate protection of public assets. Weak internal controls increase the potential for the occurrence of fraud and undetected accounting errors. The city's decentralized voucher system contributed to the weaknesses noted.

We recommend that management establish and implement internal controls and accounting procedures to strengthen their voucher system.

6. The City Should Properly Use Contracts For Services

During our examination, we requested the city provide us with 15 contracts and/or agreements for our review. The city was unable to locate eight of these contracts. We found the city did not have contracts for their use of computer programming, legal services, engineering services, and a lease agreement for building rental. We found that the services of the city attorney was not only acquired without a contract, the attorney was paid as a part-time employee with medical benefits. Of the seven contracts we reviewed we found the following:

- a. Two of the contracts did not have proper authorized signatures.
- b. One contract had expired in 1988 and had not been renewed.
- c. Two contracts did not meet contractual specifications as described in state regulations, (missing contract duration, evidence agreement filed or purpose of contract).

RCW 39.34.030 states in part:

Appropriate action by ordinance, resolution or otherwise pursuant to law of the governing bodies of the participating public agencies shall be necessary before any such agreement may enter into force.

RCW 39.34.080 states in part:

... each public agency entering into the contract is authorized by law to perform: PROVIDED, that such contract shall be authorized by the governing body of each party to the contract. Such contract shall set forth fully the purposes, powers, rights, objectives, and responsibilities of the contracting parties.

The city has not established centralized control over issuance, execution and monitoring of contracts and/or agreements, or leases. The city management and administration were not aware of all legal contracts and/or agreements by which the city is legally obligated.

We recommend city management and administration establish and implement procedures which will assure the proper use of contracts for acquiring services. We also recommend that all contracts and/or agreements contain all necessary and required elements as prescribed by Chapter 39.34 RCW.

7. The City Does Not Have Established Information Engineering Controls

The design and implementation of the city's payroll system were completed without adequate attention to the need for proper application and accounting controls. Testing of the end product was not properly completed before use was authorized. Our review of this system revealed those conditions as noted in paragraph a. of Finding 1.

The *Electronic Data Processing Auditor's Foundations, Control Objectives*, Section 2.1, states:

The process followed by an organization in the development, acquisition, and maintenance of information systems should attempt to achieve system effectiveness, economy and efficiency, data integrity, resource safeguarding, and compliance with laws and regulations. The use of an effective system development life cycle methodology should provide the County's senior management with reasonable assurance that these objectives will be achieved.

The *Electronic Data Processing Auditor's Foundations, Control Objectives*, Section 2.5.4, states:

The organization's system development life cycle methodology should provide that the procurement of contract programming services be justified with a written request for service from a project manager. The end product of complete contract programming services should be tested and reviewed by the information services function quality assurance group before payment for the work and the end product is authorized.

A weakness in, or lack of, controls in the system development life cycle increases the likelihood that systems are not designed according to user needs. This could also result in incorrectly implemented system and program modifications, and/or the programs may be subjected to unauthorized modifications.

Management failed to take responsibility for ensuring that proper controls would be developed as part of the software installation project. The city does not have formal policies or procedures for making modifications to programs. The programmer made changes to the live production data. A library is not used to test programs. The city did not approve programs completed or test data.

We recommend that management establish and implement controls and procedures which provide for roles and responsibilities in the planning, developing, reviewing, implementation, and auditing of the end product of the information engineering process. The city authorizations should be obtained throughout each phase. Testing and supporting documentation should be retained.

CITY OF CHENEY
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Schedule Of Federal Findings

1. An Accounting System For Fixed Assets Should Be Put In Place

As reported in prior audits, the city has still not developed a system of accounting for the fixed assets as required by federal directives. Nor are they following their own fixed asset accounting policies. There are no complete detailed subsidiary listings of the utilities' fixed assets. Annual physical inventories of the city's fixed assets are incomplete; documentation is insufficient to verify the existence, location, and condition of property owned by the city. The city's fixed assets are not tagged.

The "Common Rule" for *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments*, issued by the Office Management and Budget, March 1988, requires in Subpart C, Section __.32(d)(1):

Property records must be maintained that include a description of the property, serial number or other identification number, the source of the property, who holds the title, the acquisition date, and the cost of the property, percentage of Federal participation in the cost of the property, the location, the use and condition of the property, and any ultimate disposition data including the date of disposal, and price of the property.

The city's management is aware of these deficiencies. Discussion with the city's finance director indicates that the city is still in the process of implementing an improved system of accounting for the city's fixed assets. Without a fixed assets accounting system the city is unable to fix responsibility for the safeguarding, or establish responsibility for custody and proper use of these assets. The city is also unable to prepare complete and accurate financial reports, meet federal requirements, and adhere to the city's established requirements.

We again recommend the city implement a system of accounting for fixed assets.